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Discussion of 'Does measuring intangibles for management purposes improve performance? A review of the evidence'

Julian Heslop*

I have spent over 30 years in industries ranging from brewing, foods, property and latterly pharmaceuticals and consumer healthcare.

I am convinced from my own experience that measuring intangibles for management purposes does improve performance.

What are these intangible assets? They are the patents that protect our medicines that take over ten years of high risk research and development (R&D) to create; they are the trademarks that protect our consumer healthcare brands; and in other industries they are the intellectual property that have generally taken years of investment and consumer experience to create. The return to companies and their investors for this significant development investment is intellectual property protection that allows for future premium pricing and higher volume sales.

GlaxoSmithKline (GSK) has an enterprise value of some £65bn compared to a net asset value (before debt) if you look at the most recent consolidated balance sheet of £16bn. The main difference between the two is the value of the company's intellectual property comprising its marketed medicines, vaccines and consumer healthcare brands but also its new product pipeline. Under current accounting, which I believe to be correct, there is no capitalisation of internal R&D costs.

Hopefully the preceding paragraph makes clear that intangibles have significant value for GSK as they do for many other companies and that this value is reflected in the premium prices received for products protected by intangible assets. Given this value it is important that intangibles are appropriately monitored for internal management purposes to ensure their value is preserved and enhanced.

Certain simple financial measures such as absolute sales and profit values and comparative growth to previous accounting periods provide clear measures of performance for both internal

management and for external investors. However, these generally reflect what has happened rather than the key drivers of future performance.

My biggest lesson in this respect was when I was sent as a young accountant to the East Coast of the US for a short period and worked with a small restaurant chain which primarily served families. The business was performing well; sales, profit and spend per customer were all increasing and management were pleased with the progress being made and attributed it to the innovative changes they had recently made to the menu. However, fortunately, there were other measures also used by management to assess progress in building 'the restaurant chain's value reputation' as it was this intangible that was the key to future growth in a very competitive market. Significantly, one key measure which was falling was 'value for money'. The lesson from this was that sales and profit would shortly decline if no action was taken as this sector was highly competitive and very value-for-money focused.

Analysis revealed that the new menu with its greater choice and higher prices may have pleased most of the restaurant's customers but did not please the payer (usually the father in those days) who found the bill some 20% higher than he expected. Additionally, although sales were rising the number of customers began to fall. In conclusion, the business was forced to change the menu and delete some of the higher-priced items and fortunately did so before the brand reputation for value had been inexorably weakened. I left the US with a clear understanding of the importance of measuring brand health and not being totally focused on just the key financial measures.

In my present business there are a number of non-financial measures that provide an assessment of the intellectual property that drive the majority of the value of the business. These include, as you would expect in the pharmaceutical industry, safety monitoring but also market share and other customer market data that monitor the relative strength of the company's products. We monitor

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these and react to changes.

Within our R&D organisation, for example, employees are incentivised based on progress in meeting objectives to move projects through the pipeline to approval. This is critical in providing new medicines for society and for driving future sales growth.

In conclusion, measuring intangibles which represent the most significant part of many companies' value is important in improving performance. Linking employee remuneration to these

measures is beneficial where employees have a direct impact on the measure, but generally not otherwise. It is important that there is consistency of measurement over time and that management focuses on the few key measures that will drive future value. It is as damaging to dilute management by focusing on too many measures as it is to look at none at all.

Increasingly in the 21st century, enhancing the value of intangibles will be key to future wealth creation and economic prosperity.